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When is Private Investment Not Private Investment?

When Government's the One Investing (Social Security Money)

Regrettably, it seems tonight's State of the Union address will mark a step backwards for Social Security. It appears that the President will not opt for real reform, despite the fact that just a month ago at the White House conference on Social Security, he appeared to be moving in that direction in considering private investment by private individuals as an option for at least a portion of an individual's Social Security payroll taxes. Instead, now it seems he wants the federal government to not only retain complete control of Social Security, but to extend its control into the private sector by itself becoming an investor.

Let there be no mistake: Government investment is *not* a step toward real reform, but is a gigantic step backwards. Government investment in the private sector is *not* private investment. It's closer to manipulation of the free marketplace, and as such, actually could undermine the free enterprise system. Again, the President has only flirted with real reform opting for rhetoric that is more dangerous than the problem he ostensibly seeks to solve.

Social Security: The Future is Coming

The chairman of the House Ways and Means Committee, Bill Archer, last year laid out Congress' goals for Social Security: that it be fair to current and future retirees, especially women; that there be no tax increases; that it remain a safety net for the needy and disabled; and that there be new options for younger workers. If President Clinton had honestly attempted to take some cautious steps in moving beyond the pledge he made a year ago toward bipartisan reform, this Congress would eagerly join him. It was commendable that the President had apparently acknowledged at the White House Social Security conference last year that:

- Social Security's future is both a major and an immediate problem — the year 2013 marks when Social Security tax receipts no longer will meet obligations — and not one that can be fixed by minor adjustments sometime in the future;

- Tax increases are not the solution; (Faced with exploding future costs and payroll taxes already taking 12.4 percent from workers' paychecks, this is not a problem that we can tax our way out of.)

- The best way to reform Social Security is to increase its currently low rate of return to beneficiaries — and that this is best done through investment in the private sector.

Yet just a month later President Clinton has already left the promising track he seemed to be following. Because private-sector investment by the federal government is not private investment, such a proposal will not only undermine the goals of Social Security reform, it will undermine the private-sector economy itself. In short, government investment is simply too risky.

What's Wrong With Government Investment?

Taxpayers' confidence in Social Security is already very low. A poll conducted with GOP pollster Frank Luntz four years ago found that more young Americans believe in UFOs than believe that Social Security will be there for them when they retire. Clearly, our first goal in reforming Social Security should be to increase people's confidence. Yet, a recent (12/9/98) *Associated Press* poll showed that while 75 percent of people favored allowing payroll tax receipts in the stock market, 68 percent opposed the government being the investor. Interestingly, the President himself acknowledges this situation: "How will you ever convince the American people . . . since they always believe the government will mess up a two-car parade?" *[Orlando Sentinel,* 11/29/98].

Yet, now President Clinton appears to have rejected both the people's preferences and his own best advice.

Taxpayers have good reason to be wary of government investment. Here's what Federal Reserve Chairman Alan Greenspan had to say about government investment of Social Security receipts in a hearing before the Senate Banking Committee on July 21, 1998: "I think it's very dangerous . . . I don't know of any way that you can essentially insulate government decision-makers from having access to what will amount to very large investments in American private industry. . . . I am fearful that we are taking on a position here, at least in conjecture, that has very far-reaching potential dangers for a free American economy and a free American society." The following points offer an elaboration of Chairman Greenspan's concern:

- **Having the government pick winners and losers distorts the private economy**. The private sector works best precisely because it makes unbiased decisions based on the concerns of countless investors and customers. Government investment, which would be on a comparatively massive scale, will bias — even if unintentionally — the market toward its investments rather than following the market as true private investment should.

- **Government investment will not be unbiased**. The government, controlled by politicians and bureaucrats, will inevitably succumb to political pressure, ideological interests, and local concerns when making its investments. "Would politicians let taxpayer money buy shares of tobacco companies such as Philip Morris and RJR Nabisco, Inc., which represent 2.4 percent of S&P's 500?" asks James Glassman in a recent column. Or, "what about buying $33 billion worth of Microsoft Corp., the largest S&P stock and a company that the government is prosecuting on antitrust charges? Or stock in firms that use cheap foreign labor, trade with unsavory countries or spread pollution?" [Glassman, *Washington Post,* 12/8/98].

- **Government intervention in nations' economies is a proven failure.** From the complete control of communism to the state-manipulated investments of Asia, these efforts have all met with failure. Even the recent massive stock purchases by the Hong Kong government, which amounts merely to indirect control, have shaken international finance markets' confidence in what had until recently been considered one of the world's best markets.

In addition to Chairman Greenspan's concerns, other valid concerns about government investing in the private sector have been made. For one, the costs of government investment will inevitably be paid by Social Security beneficiaries, the economy, and the nation as a whole. Let's look at this concern and how government investment results in lower returns.

- **Social Security beneficiaries will suffer**. That's because Government investments — that distort the private sector and are influenced by political decisions — will inevitably lead to lower returns than otherwise would have occurred.

- **The economy will also suffer.** That's due to massive shifts in resources to areas where they otherwise would not have gone causing the economy to use them less productively than they should have been. This means lower economic growth — fewer jobs, lower wages, and lower profits — than would otherwise have resulted.

- **Finally, the nation will suffer.** Lower returns for Social Security beneficiaries, workers, employers, and investors all mean greater demands on the government (for subsidies, unemployment benefits, etc.) and lower resources with which to meet these demands — i.e., lower tax revenues. Lower revenues means that the government must borrow the money, which reinforces the negative economic performance, or that people do without — precisely the opposite of our Social Security reform efforts.

In short, government investment in the private sector is too risky — not simply for Social Security, but for the economy and nation as well.

What About Individual Investment of Social Security Dollars?

To be truly private, investment must be under the control of individuals — not bureaucrats and politicians. Again quoting from Fed Chairman Greenspan: "I am strongly supportive of going to private funding where individuals control the claims on corporations." What are the options?

- One option is to permit privately-held and privately-administered accounts with qualified outside entities — such as those currently used on a large scale in such instruments as IRAs and 401(k) plans.

- Another option is to permit privately controlled personal accounts with diversified but limited investment options that are administered by an independent private entity — such as is currently done on a large scale with the federal employees' retirement savings under the Thrift Savings Plan (TSP). This system allows for safeguards for investors as well as minimal transaction costs — thus maximizing the investor's security and return.

[See, for an elaboration, RPC's paper, "Could Congress' Retirement Plan Serve as a Model to Reform Social Security?", 3/10/98.]

Social Security desperately needs, and its beneficiaries deserve, the higher rates of return offered by private investment. However, no one should be deluded or encouraged that government investment is private investment or that it will achieve the reform that Social Security needs.

Disappointing the Expectations of Real Reform

Despite having waited a year for him to seriously address the issue of Social Security reform — something he only mentioned in last year's State of the Union address — and despite having flirted with real Social Security reform as recently as last month, President Clinton has once again disappointed the expectations of the American people in their hopes for real reform.

Apparently, the President has once again chosen rhetoric over reform and politics over sound policy. And he has done so by choosing government investment over private investment and bureaucrats over individual working Americans.

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